

**DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 94-0668 IT**

**Gross Income Tax — Best Information Available
Adjusted Gross Income Tax — Foreign Source Dividends
Tax Administration — Negligence Penalty
For Tax Periods: 1986 Through 1989**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Income Tax — Best Information Available

Authority: IC 6-8.1-5-1(a) and (b)

Taxpayer protests the Department's approval of the sampling technique used by Audit in calculating taxpayer's taxable Indiana gross income.

II. Adjusted Gross Income Tax — Foreign Source Dividends

Authority: 45 IAC 3.1-1-29; 45 IAC 3.1-1-60; 45 IAC 3.1-1-61

Taxpayer protests the Department's determination that certain income was subject to Indiana apportionment.

III. Tax Administration — Negligence Penalty

Authority: IC 6-8.1-10-2.1
45 IAC 15-11-2

Taxpayer protests the Department's imposition of a ten-percent (10%) negligence penalty.

STATEMENT OF FACTS

The following narrative appeared in the initial letter of findings:

Taxpayer is in the computer and information management business. Taxpayer designs, manufactures, and sells computer systems and software. Additionally, taxpayer leases equipment and provides related services, maintenance contracts, facilities planning, as well as a variety of custom products.

Taxpayer filed Form IT-20 for tax periods 1986 through 1989. On schedules (Schedule F-1) attached to Form IT-20, taxpayer reported amounts of dividend income as "nonbusiness income"—income not subject to apportionment for Indiana adjusted gross income tax purposes. Audit characterized the dividend income as "business income." Audit's reclassification resulted in an increase in taxpayer's Indiana adjusted gross income.

Audit also discovered that taxpayer had failed to segregate its Indiana gross receipts on its Indiana gross income tax returns. Additionally, Audit found that taxpayer's records could not support the amounts that were reported by taxpayer on its Indiana returns. Consequently, the audit was based on the best available information.

Taxpayer protested the proposed assessments of additional Indiana gross and adjusted gross income tax. At a subsequent administrative hearing, Taxpayer's protest was denied. Taxpayer then timely requested, and the Department granted, a rehearing.

I. Gross Income Tax — Best Information Available

DISCUSSION

Audit used a sampling technique to compute taxpayer's taxable gross receipts. Taxpayer argued the sampling technique used overstated its Indiana sales, and consequently, its taxable Indiana gross income. Again, from the initial letter of findings:

As an acceptable alternative, taxpayer suggests the use of its sales receipt figures. Taxpayer believes that if Audit had used the sales receipt figures taken from taxpayer's previously audited sales tax returns, a more accurate determination of gross income would have resulted.

Taxpayer contends that its gross income for the years in question should equal its Indiana sales receipts as reported on audited sales tax returns. Taxpayer reasons that since the sales tax receipts were the basis for its quarterly estimated gross income tax, these sales tax receipts should also be an accurate estimation of its annual gross receipts.

The Department, at the initial hearing, upheld Audit's reliance on the best information available in calculating Taxpayer's gross income and tax. The Department based its decision on two (2) statutory authorities. IC 6-8.1-5-1(a) authorizes the following:

If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department.

And according to IC 6-8.1-5-1(b):

The rate of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

Taxpayer now revisits its original argument. Taxpayer questions Audit's adoption of a sampling technique to compute Taxpayer's Indiana gross income. Taxpayer contends its Indiana gross receipts should equal its Indiana gross retail income. And since its Indiana gross retail income was established in a relatively contemporaneous Indiana sales/use tax audit, this figure should be accepted by the Department as Taxpayer's gross receipts for Indiana gross income tax purposes.

The Department notes that "gross receipts" and "gross retail income" are not synonymous concepts and, therefore, may not (and usually do not) represent equivalent amounts. Gross receipts for gross income tax purposes "means all the gross receipts a taxpayer *receives...from trades, businesses, or commerce*" with certain exceptions. IC 6-2.1-1-2. On the other hand, "[g]ross retail income" means the total gross receipts, of any kind or character, *received in a retail transaction*, except that part of the gross receipts attributable to:

- (1) the value of any tangible personal property received in a like kind exchange in the retail transaction; or
- (2) the receipts received in a retail transaction which constitute interest, finance charges, or insurance premiums on either a promissory note or an installment sales contract.

IC 6-2.5-1-5(a).

Taxpayer has failed to show that its "gross retail income" is equal to its "gross receipts" as defined by IC 6-2.1-1-2. Additionally, Taxpayer was unable to verify the "gross retail income" figure provided to the Department.

FINDINGS

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax — Foreign Source Dividends

DISCUSSION

Taxpayer protested the characterization of a portion of its foreign source dividends as "business income"—income subject to apportionment for Indiana adjusted gross income tax purposes. Taxpayer asserted such income was non-business in nature.

Taxpayer advanced two (2) arguments in its initial protest:

Taxpayer's regular trade or business was the design, manufacture and marketing of electronic based information systems. Taxpayer contends its principle business is not the holding of the investment in its subsidiaries. This activity is incidental to the regular business conducted by the taxpayer. Reference is made to the United States Supreme Court decision in Allied-Signal, Inc. v. Director of Taxation, decided June 15, 1992. Pursuant to this decision, Taxpayer contends the receipt of these Subpart F dividends has no connection with the activities carried on in the State of Indiana. Because of this, the non-business income classification of these dividends should be restored.

Furthermore, Taxpayer contends Indiana's treatment of Subpart F income is facially discriminatory against foreign commerce in violation of the Foreign Commerce Clause of the United States Constitution. Reference is made to the United States Supreme Court decision in Kraft General Foods, Inc. v. Iowa Department of Revenue, decided June 18, 1992.

The Department, in denying Taxpayer's protest, stated:

While *Allied Signal* does provide guidance, absent additional facts, the Department is unable to determine whether taxpayer's situation is analogous to that of the taxpayer in *Allied-Signal*....[T]axpayer has failed to develop legal arguments, discuss Indiana authorities, or provide additional supporting information.

Taxpayer's constitutional argument failed as well. At rehearing, Taxpayer re-introduced both arguments.

Substantively, the issue is not whether these foreign source dividends should be characterized as business or non-business income, but rather, whether Indiana is entitled to an apportioned share of such income. In Indiana, corporations may deduct from its adjusted gross income certain foreign source dividends. Specifically, IC 6-3-2-12(b) states:

A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is entitled to a deduction from that adjusted gross income. The amount of the deduction equals the product of:

- (1) the amount of the foreign source dividend included in the corporation's adjusted gross income for the taxable year; multiplied by
- (2) the percentage prescribed in subsection (c), (d), or (e), as the case may be.

The amount to be deducted (dividend times percentage) depends upon the percentage of stock owned by Taxpayer in the foreign corporation from which the dividend is derived. The allowable percentages range from fifty percent (50%) to one hundred percent (100%). IC 6-3-2-12(c) through (e).

Taxpayer's income represents foreign source dividends. Taxpayer, therefore, must include these dividends in its Indiana adjusted gross income. However, pursuant to IC 6-3-2-12, Taxpayer may deduct a percentage of these dividends consistent with the statutory schedule. Audit will review the available information to determine the appropriate percentages and deductible amounts. Taxpayer's liabilities will then be adjusted accordingly.

FINDINGS

Taxpayer's protest is denied.

III. Tax Administration — Negligence Penalty

DISCUSSION

Taxpayer protests the Department's imposition of the ten-percent (10%) penalty. A negligence penalty may be imposed under IC 6-8.1-10-2.1 and 45 IAC 15-11-2.

45 IAC 15-11-2 provides:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-2.1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In its initial letter of findings, the Department noted:

Taxpayer attributes any underreporting to "exceptional circumstances." Taxpayer also maintains that the turnover of personnel in the tax department, both before and during the audit, contributed to the reporting discrepancies.

While taxpayer has offered an explanation for these tax discrepancies, taxpayer has not shown reasonable cause under 45 IAC 15-11-2.

Since the circumstances attributed to Taxpayer's underreporting of its Indiana tax liabilities have not changed, the Department's characterization of those circumstances remains the same.

FINDING

Taxpayer's protest is denied.